

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF MCCREARY	)	
COUNTY WATER DISTRICT FOR (1) A	)	
CERTIFICATE OF PUBLIC CONVENIENCE)	)	
AND NECESSITY, AUTHORIZING AND	)	
PERMITTING SAID WATER DISTRICT TO)	)	
CONSTRUCT A WATERWORKS	)	
CONSTRUCTION PROJECT, CONSISTING	)	
OF EXTENSIONS, ADDITIONS, AND	)	
IMPROVEMENTS TO THE EXISTING	)	CASE NO. 8720
WATERWORKS SYSTEM OF THE	)	
DISTRICT; (2) APPROVAL OF THE	)	
PROPOSED PLAN OF FINANCING OF	)	
SAID PROJECT AND (3) APPROVAL OF	)	
THE INCREASED WATER RATES	)	
PROPOSED TO BE CHARGED BY THE	)	
DISTRICT TO CUSTOMERS	)	
OF THE DISTRICT	)	

O R D E R

The McCreary County Water District ("McCreary County") filed its application on November 1, 1982, for approval of adjustments to its water service rates, authorization to construct a \$785,000 waterworks improvement project and approval of its plan of financing for this project. The planned financing included a \$400,000 grant from the Appalachian Regional Commission ("ARC") and Farmers Home Administration ("FmHA") loans totaling \$385,000 as follows: \$285,000 at 5 percent interest and \$100,000 at 11 3/8 percent interest. Waterworks revenue bonds are to be issued as security for these loans. The repayment period will be 40 years.

Plans and specifications for the proposed improvements as prepared by Kennoy Engineers, Inc., of Lexington, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet ("Natural Resources").

A hearing was held February 15, 1983, in the offices of the Public Service Commission, Frankfort, Kentucky. Mrs. Pat Terry and Mr. Grayson Deel, customers of McCreary County, intervened and expressed concern about the effect of the proposed rates on high volume customers. Mrs. Terry owns the People's Laundry in Whitley City. Mr. Deel represented the Pine Knott Conservation Center, a Job Corps Training Center.

On April 29, 1983, the Commission forwarded a staff report and draft order regarding the proposed construction to McCreary County and ordered this case set for further hearing to receive testimony with respect to the report and Order. This hearing was held on May 4, 1983, in the offices of the Public Service Commission, Frankfort, Kentucky. At this hearing, the Commission staff report concerning the operation of the proposed 500,000-gallon water storage tank was entered into the record. McCreary County was allowed to comment on the staff report and the draft order and to provide additional information.

On May 23, 1983, McCreary County was notified by letter that a second staff report concerning the operation of the proposed 500,000-gallon water storage tank was to be entered into the record in this case. McCreary County was allowed until June 3, 1983, to comment on this report. On June 3, 1983, McCreary

County filed additional information in response to the Commission's May 23, 1983, letter in order to substantiate further the adequacy of the proposed 500,000-gallon water storage tank. This information demonstrates that in order to maintain adequate flow and pressure in the water distribution system, modifications would have to be made in the operation of two of the existing tanks and the high service pumps would have to be operated 20 hours daily.

McCreary County requested approval of increased rates for water service which would provide an increase in operating revenues of \$97,749. In this Order, the Commission has allowed an increase in operating revenues of \$66,303.

#### TEST PERIOD

McCreary County proposed and the Commission has accepted the 12-month period ending June 30, 1982, as the test period in this matter.

#### REVENUES AND EXPENSES

McCreary County's net operating income for the test period was \$11,188. In order to reflect expected operating conditions subsequent to completion of the proposed construction project, McCreary County proposed numerous adjustments to revenues and expenses resulting in an adjusted net operating loss of \$2,844. The Commission finds McCreary County's proposed adjustments to be generally proper and has accepted them for rate-making purposes with the following exception:

### Depreciation Expense

McCreary County adjusted depreciation expense by \$7,700 to reflect additional depreciation from the construction project. The Commission has further adjusted depreciation expense in accordance with its policy that depreciation should be computed on the basis of original cost of the plant in service less contributions in aid of construction. The Commission is of the opinion that it is unfair to require ratepayers to provide recovery on that portion of plant which has been provided free of cost. Therefore, the Commission finds that reasonable depreciation expense for rate-making purposes is \$40,219,<sup>1/</sup> a reduction in adjusted depreciation expense of \$37,429.

Therefore, the Commission finds that McCreary County's adjusted test period operations are as follows:

	<u>McCreary County Adjusted</u>	<u>Commission Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$ 399,017	\$ -0-	\$399,017
Operating Expenses	401,861	(37,429)	364,432
Net Operating Income	<u>\$ (2,844)</u>	<u>\$ 37,429</u>	<u>\$ 34,585</u>
Other Income	<u>\$ 5,044</u>	<u>-0-</u>	<u>\$ 5,044</u>
Income Available for Debt Service	<u>\$ 2,200</u>	<u>\$ 37,429</u>	<u>\$ 39,629</u>

### REVENUE REQUIREMENTS

The Commission has used the debt service coverage ("DSC") method to determine appropriate revenue requirements for McCreary County. McCreary County's pro forma average debt service for the next 5 years, including financing of the proposed construction project, is \$88,277. McCreary County's DSC on adjusted net operating income of \$34,585 plus other income of \$5,044 is .45X. The Commission is of the opinion that this DSC is unfair, unjust and

unreasonable. Furthermore, the Commission is of the opinion that a DSC of 1.2X is the fair, just, and reasonable coverage necessary for McCreary County to pay its operating expenses and to meet the requirements of its lenders. Accordingly, the Commission has determined that additional revenue of \$66,303<sup>2</sup>/<sub>1</sub> is necessary to provide the 1.2X DSC which will ensure the future financial stability of McCreary County.

#### OTHER MATTERS

##### Delinquent Principal Payments

McCreary County issued Waterworks Refunding and Improvement Bonds in 1973 to finance improvements on the system and to refund previous issues. McCreary County currently has outstanding \$631,415 of Series "A" bonds and \$172,000 of Series "B" bonds payable to the Department of Housing and Urban Development ("HUD"). Further, McCreary County is currently in default on \$47,415 of principal on the Series "A" bonds and \$9,000 on the Series "B" bonds. McCreary County asked to include a 3-year amortization of this delinquent principal in its basic rates at an annual charge of \$18,805. In theory and according to past Commission policy, principal repayment should be made from the annual depreciation charges and the profits of a utility. However, due to its limited cash-flow and its failure to make timely rate case filings, McCreary County has been unable to pay its operating expenses and meet its debt service requirements.

The Commission has reviewed McCreary County's operations and rate case history to determine the appropriateness of requiring the present ratepayers to supplement any cash flow deficiency caused by past due delinquencies. The Commission is of the opinion that in

this instance it is necessary for the ratepayers to pay a surcharge since there are no stockholders to penalize for the lack of timely rate filings. Therefore, the Commission finds it appropriate for McCreary County's ratepayers to pay a surcharge of \$0.53 per month for a period not to exceed 36 months or until total revenues of \$56,415 are collected, whichever comes first. Amounts collected under this surcharge will be applied by McCreary County solely to the settlement of the debt owed to HUD. McCreary County will be required to file with the Commission quarterly statements of payments on its indebtedness to HUD.

The Commission further advises McCreary County that future rate requests should be filed on a more timely basis to avoid recurring delinquencies, and cautions that failure to adhere to this advice could result in future financial instability.

#### RATE DESIGN

At the hearing of the case, Mrs. Pat Terry and Mr. Grayson Deel expressed concern about McCreary County's rate design, particularly its impact on large volume users. The Commission also questioned McCreary County's rate design and requested additional information to assist rate design evaluation.

The Commission has considered modifying McCreary County's rate design. However, such a task involves considerable effort that would delay issuance of this Order, and McCreary County is in need of immediate rate relief. Therefore, the Commission has determined to defer rate design restructuring considerations and advises McCreary County to include a rate design evaluation in any future case.

### SUMMARY

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. There is a need for additional water storage facilities on McCreary County's water distribution system. However, the Engineer's hydraulic analyses demonstrate that McCreary County's water distribution system will not significantly benefit from the proposed 500,000-gallon tank at its proposed location.

The Commission, therefore, finds that public convenience and necessity do not require construction of the 500,000-gallon storage tank as proposed by McCreary County.

2. McCreary County should make further studies of its distribution system for the purpose of selecting a storage tank site or sites and a tank capacity or capacities that are compatible with the flowage capacities of its existing water mains. Its subsequent proposals for storage tank construction will be reviewed and considered for approval upon receipt by this Commission.

3. With the deletion of the proposed 500,000-gallon storage tank and the substitution therefor of a storage tank or tanks that are compatible with the flowage capacities of existing water mains, public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

4. The construction approved herein includes improvements to certain components of the water treatment process for better equalization of the capacities of these components so as to effect

increased productivity and efficiency of water treatment plant operations, and the construction of a utility service building to include a meter testing laboratory and facilities for the maintenance of utility vehicles and equipment.

5. The construction recommended herein includes a storage tank or tanks with a combined capacity of 500,000 gallons or less for which plans, specifications and estimates are to be prepared and submitted to this Commission at a future date.

6. Any deviations from the construction approved herein which could adversely affect service to any customer should be subject to the prior approval of this Commission.

7. The total project costs for the construction approved and recommended herein will, on the basis of the bids received February 8, 1983, approximate \$785,000 including fees, contingencies and other indirect costs. McCreary County's financing in the amount of \$785,000 should, therefore, be approved.

8. The proposed borrowing of \$385,000 is for lawful objects within the corporate purposes of McCreary County, is necessary and appropriate for and consistent with the proper performance of services to the public by McCreary County, will not impair its ability to perform these services and is reasonably necessary and appropriate for such purposes.

9. McCreary County should furnish duly verified documentation of the total cost of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.



10. McCreary County's contract with its Engineer should require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. This supervision and inspection should insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

11. McCreary County should require the Engineer to furnish this Commission with a copy of the record plans and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

12. McCreary County has been advised by Natural Resources<sup>3/</sup> that its water impoundment dam does not meet the minimum criteria adopted by the Commonwealth of Kentucky for moderate hazard dams. The Phase II investigation, which has been estimated to cost \$20,000, should be completed during calendar year 1983. McCreary County should seek the approval of the FmHA and the ARC for setting aside contingency funds from this project to pay for the Phase II study.

13. The rates proposed by McCreary County will produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

14. The rates and charges in Appendix A are the fair, just and reasonable rates to be charged by McCreary County in that they should produce gross annual revenue of \$470,364.

15. In addition to the rates in Appendix A, McCreary County should charge its customers a surcharge.

16. McCreary County should be required to submit a quarterly statement showing amounts received from the surcharge and each payment made to HUD with copies of cancelled checks.

IT IS THEREFORE ORDERED that McCreary County be and it hereby is denied a certificate of public convenience and necessity for construction of its proposed 500,000-gallon water storage tank.

IT IS FURTHER ORDERED that McCreary County be and it hereby is granted a certificate of public convenience and necessity to proceed with the construction of the proposed water treatment plant improvements and to proceed with the construction of a building that will house a meter testing laboratory and provide facilities for the maintenance of utility vehicles and equipment as set forth in the plans and specifications of record herein.

IT IS FURTHER ORDERED that McCreary County shall make further studies of its distribution system to select a tank site or sites and a tank capacity or capacities that are hydraulically compatible with the capacities of its distribution mains. The revised proposals for construction of water storage facilities shall be submitted to this Commission for approval before any construction thereof is begun.

IT IS FURTHER ORDERED that McCreary County shall complete the Phase II investigation of its water impoundment dam as soon as feasibly possible, but no later than December 31, 1983.

IT IS FURTHER ORDERED that any deviations from the construction approved herein which could adversely affect service to

any customer shall be subject to the prior approval of this Commission.

IT IS FURTHER ORDERED that McCreary County's plan of financing in the amount of \$785,000, including 40-year loans of \$285,000 at 5 percent interest and \$100,000 at 11 3/8 percent interest from the FmHA be and it hereby is approved.

IT IS FURTHER ORDERED that McCreary County shall file with the Commission duly verified documentation which shows the total costs of the construction herein certificated including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

IT IS FURTHER ORDERED that the contract between McCreary County and its Engineer shall require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. This supervision and inspection shall insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

IT IS FURTHER ORDERED that McCreary County shall require the Engineer to furnish this Commission with a copy of the record drawings and a signed statement that the construction has been satisfactorily completed and done in accordance with the contract plans and specifications within 60 days of the date of substantial completion of the proposed construction.

IT IS FURTHER ORDERED that the rates proposed by McCreary County be and they hereby are denied.

IT IS FURTHER ORDERED that the rates and charges in Appendix A be and they hereby are approved as the fair, just and reasonable rates and charges to be charged by McCreary County for service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that McCreary County shall place into effect the surcharges in Appendix A, effective with the next billing after the date of this Order, for a period not to exceed 36 months on and after the date of the next billing or until \$56,415 has been collected, whichever first occurs.

IT IS FURTHER ORDERED that McCreary County shall file a quarterly statement with the Commission outlining the amounts collected from the surcharge and payments made to HUD. These monthly statements shall include a copy of the cancelled checks and the suppliers' invoices.


IT IS FURTHER ORDERED that within 30 days of the date of this Order, McCreary County shall file its tariffs setting out the rates approved in Appendix A.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 8th day of June, 1983.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

FOOTNOTES

1. Calculation:

Utility Plant in Service	\$ 2,628,719
Less: Contributions in Aid of Construction	<u>1,406,198</u>
Net Utility Plant in Service	\$ <u>1,222,521</u>
Composite Depreciation Rate	<u>X 2.66%</u>
Depreciation Expense on Plant in Service	\$ <u>32,519</u>
Plus: Depreciation Expense on Proposed Construction	<u>7,700</u>
Adjusted Depreciation Expense	<u>\$ 40,219</u>

2. Adjusted Operating Expenses	\$ 364,432
1.2X Debt Service (\$88,277)	<u>105,932</u>
Revenue Requirement	\$ <u>470,364</u>
Less: Adjusted Operating Revenue + Other Income	<u>404,061</u>
Increase Allowed	\$ <u>66,303</u>

3. This Commission was advised of this matter by a letter dated February 9, 1983, from Natural Resources. The letter was brought out during the hearing by the Engineer's testimony, pages 40 and 41 of the hearing transcript.

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 8720 DATED JUNE 9, 1983

The following rates and charges are prescribed for the customers in the area served by McCreary County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

Water Service

<u>Consumption</u>	<u>Rate</u>
First 2,000 gallons	\$6.42 (Minimum Bill)
Next 8,000 gallons	2.45 per 1,000 gallons
Next 10,000 gallons	1.87 per 1,000 gallons
Over 20,000 gallons	1.17 per 1,000 gallons

Surcharge

An itemized surcharge in the amount of \$0.53 shall be added to the monthly bill of each customer served by McCreary County Water District, subject to conditions outlined in this Order.